

Hospital Sisters
HEALTH SYSTEM

**Annual Report and Audited
Financial Statements**

June 30, 2017



Hospital Sisters Services, Inc.

This report is delivered in satisfaction of the obligations created by the Disclosure Agreement dated November 1, 2014 (the "Master Agreement") and, executed and delivered by Hospital Sisters Services, Inc. (the "Corporation") in connection with the issuance of the Bonds listed on Exhibit C. Terms used herein and not otherwise defined shall have the meanings ascribed thereto in the Disclosure Agreement.

Section 2 of the Disclosure Certificate requires the Corporation to provide an Annual Report which updates certain information which was originally provided in its Official Statement dated November 5, 2014 (the "Official Statement") relating to the issuance of the Bonds.

FINANCIAL INFORMATION

Attached to this Annual Report as EXHIBIT A are the audited consolidated financial statements of the Corporation for the fiscal years ended 2016 and 2017 which have been prepared in accordance with generally accepted accounting principles as promulgated from time to time by the Financial Accounting Standards Board, and have been audited by the accounting firm, KPMG, LLP.

INFORMATION REGARDING THE CORPORATION AND RESULTS FROM OPERATIONS

Attached to this Annual Report as EXHIBIT B is the following information, substantially similar in form and scope to the financial information and operating data originally set forth in Appendix A to the Official Statement under the captions

- (i) List of Obligated Group
- (ii) List of Affiliates of the Corporation
- (iii) Total licensed and staffed beds of Obligated Group
- (iv) Updated tables provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Condensed Consolidated Balance Sheet of Hospital Sisters Health System";
- (v) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Consolidated Summary Statements of Operations of Hospital Sisters Health System";
- (vi) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION – Obligated Group Relative to HSHS";
- (vii) Updated Income Available for Debt Service table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION – Coverage of Historical and Pro Forma Historical Maximum Annual Debt Service" (Historical Maximum Annual only) for the most recent fiscal year;
- (viii) Updated information provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Outstanding Indebtedness of the Obligated Group;
- (ix) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION – Historical and Pro Forma Capitalization" (Historical Only);
- (x) Updated table provided under the heading "SELECTED OPERATIONAL, STATISTICAL, AND FINANCIAL INFORMATION – Liquidity and Investments";

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*An Affiliate of
Hospital Sisters
Health System*

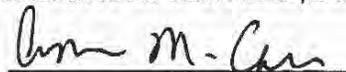
- (xi) Updated asset allocation table provided under the heading "SELECTED OPERATIONAL, STATISTICAL AND FINANCIAL INFORMATION - Investment Policy";

The information provided in the attached Exhibit B is true and correct as of the date of this Annual Report.

IN WITNESS WHEREOF the undersigned has executed and delivered the Annual Report to the Dissemination Agent, for distribution for the benefit of Holders of the Bonds, all as of this 14^h day of November, 2017.

HOSPITALSISTERS SERVICES, INC.

By:



Ann M. Carr

Its: Obligated Group Agent



HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Financial Statements and Supplementary Information

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)



Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in schedules 1 through 6 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Chicago, Illinois
October 17, 2017

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Balance Sheets

June 30, 2017 and 2016

(Dollars in thousands)

Assets	2017	2016
Current assets:		
Cash and cash equivalents	\$ 112,810	94,407
Receivables:		
Patients' accounts, less allowance for uncollectible accounts of approximately \$115,900 in 2017 and \$120,200 in 2016	426,821	394,879
Due from third-party reimbursement programs	2,491	2,274
Other	37,641	34,092
Total receivables	466,953	431,245
Current portion of assets whose use is limited or restricted	317,603	251,763
Inventories	48,021	45,574
Prepaid expenses	29,615	25,418
Total current assets	975,002	848,407
Assets whose use is limited or restricted, net of current portion	1,613,977	1,626,726
Property, plant, and equipment, net	1,410,180	1,342,416
Other assets	97,809	65,919
	\$ 4,096,968	3,883,468
Liabilities and Net Assets		
Current liabilities:		
Current installments of long-term debt	\$ 30,257	29,122
Long-term debt subject to short-term remarketing agreements	220,215	155,345
Current portion of estimated self-insurance liabilities	51,911	35,186
Accounts payable	105,770	103,485
Accrued liabilities	160,514	161,299
Estimated payables under third-party reimbursement programs	59,981	56,784
Total current liabilities	628,648	541,221
Long-term debt, excluding current installments	522,114	482,477
Estimated self-insurance liabilities	78,564	70,773
Derivative instruments	47,906	71,267
Accrued benefit liability	346,812	514,273
Other noncurrent liabilities	51,640	50,863
Total liabilities	1,675,684	1,730,874
Net assets:		
Unrestricted	2,353,270	2,093,726
Temporarily restricted	40,145	31,432
Permanently restricted	27,869	27,436
Total net assets	2,421,284	2,152,594
	\$ 4,096,968	3,883,468

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Statements of Operations and Change in Unrestricted Net Assets

Years ended June 30, 2017 and 2016

(Dollars in thousands)

	2017	2016
Net patient service revenues	\$ 2,323,186	2,227,721
Provision for uncollectible accounts	(40,871)	(31,419)
Net patient service revenue less provision for uncollectible accounts	2,282,315	2,196,302
Other revenues:		
Investment income (loss)	595	(286)
Net assets released from restrictions used for operations	4,207	5,105
Other	77,425	76,508
Total revenues	2,364,542	2,277,629
Expenses:		
Sisters' services	1,036	1,128
Salaries and wages	851,307	840,256
Employee benefits	209,560	196,209
Pension expense, excluding mark-to-market adjustment	23,359	32,350
Pension expense, mark-to-market adjustment	(59,761)	257,203
Professional fees	121,882	113,316
Supplies	342,568	324,850
Depreciation and amortization, excluding Belleville campus	155,159	151,571
Accelerated depreciation on Belleville campus	7,479	7,479
Interest	11,213	11,931
Other	634,159	572,289
Total expenses	2,297,961	2,508,582
Income (loss) from operations	66,581	(230,953)
Nonoperating gains (losses):		
Investment income (loss)	147,152	(34,414)
Contributions of Good Shepherd unrestricted net assets	19,124	—
Contributions of Holy Family unrestricted net assets	—	749
Change in fair value of interest rate swaps	23,361	(22,533)
Revenues and gains in excess (deficient) of expenses and losses before discontinued operations	256,218	(287,151)
Net gains (losses) from discontinued operations	2,933	(55,210)
Revenues and gains in excess (deficient) of expenses and losses	259,151	(342,361)
Other changes in unrestricted net assets:		
Net assets released from restrictions used for the purchase of property, plant, and equipment	92	667
Recognition of change in pension funded status	301	580
Change in unrestricted net assets	\$ 259,544	(341,114)

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2017 and 2016

(Dollars in thousands)

	2017	2016
Unrestricted net assets:		
Revenues and gains in excess (deficient) of expenses and losses	\$ 259,151	(342,361)
Other changes in unrestricted net assets:		
Net assets released from restrictions used for the purchase of property, plant, and equipment	92	667
Recognition of change in pension funded status	301	580
Change in unrestricted net assets	259,544	(341,114)
Temporarily restricted net assets:		
Investment income	1,284	40
Contributions	10,470	11,399
Contribution of Good Shepherd restricted net assets	1,258	—
Contribution of Holy Family restricted net assets	—	11
Net assets released from restrictions	(4,299)	(5,772)
Change in temporarily restricted net assets	8,713	5,678
Permanently restricted net assets:		
Investment income	21	3
Contributions	352	647
Contribution of Good Shepherd restricted net assets	60	—
Contribution of Holy Family restricted net assets	—	967
Change in permanently restricted net assets	433	1,617
Change in net assets	268,690	(333,819)
Net assets at beginning of year	2,152,594	2,486,413
Net assets at end of year	\$ 2,421,284	2,152,594

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Statements of Cash Flows

Years ended June 30, 2017 and 2016

(Dollars in thousands)

	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ 268,690	(333,819)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Loss on disposal of SMS	—	40,569
Pension expense, mark-to-market adjustment	(59,761)	261,316
Recognition of change in pension funded status	(301)	(587)
Income from equity basis investments	(3,123)	(1,989)
Cash distributions received from equity basis investments	4,928	2,650
Net assets released from restrictions and used for operations	4,207	5,105
Contribution of Good Shepherd net assets	(20,442)	—
Contribution of Holy Family net assets	—	(1,727)
Restricted contributions and investment return	(12,127)	(12,089)
Amortization of bond issuance costs and premiums/discounts included in interest expense	(5,638)	(6,183)
Depreciation and amortization	162,638	159,050
Provision for uncollectible accounts	40,871	32,528
Change in net unrealized gains and losses on investments	(64,832)	83,169
Net realized gains on sale of investments	(65,425)	(29,146)
Change in the fair value of derivative instruments	(23,361)	22,533
Changes in assets and liabilities:		
Patients' accounts receivable	(70,603)	(67,938)
Other receivables	(3,549)	(28)
Inventories	(2,272)	(1,282)
Prepaid expenses	(3,936)	(1,701)
Net amounts due to third-party reimbursement programs	2,683	(10,236)
Accounts payable and accrued liabilities	(1,126)	(7,054)
Estimated self-insurance liabilities and other noncurrent liabilities	(82,106)	(59,076)
Net cash provided by operating activities	65,415	74,065
Cash flows from investing activities:		
Acquisition of property, plant, and equipment	(219,221)	(221,855)
Cash received from contribution of Good Shepard	412	—
Cash received from contribution of Holy Family	—	606
Cash paid for Door County	(40,000)	—
Gross purchases of investments	(2,088,241)	(1,733,706)
Gross proceeds from sale or maturity of investments	2,181,971	1,842,472
Change in other assets	6,812	(1,187)
Net cash used in investing activities	(158,267)	(113,670)
Cash flows from financing activities:		
Repayment of long-term debt	(101,508)	(13,033)
Proceeds from issuance of debt	206,902	—
Payment of bond issuance cost	(2,059)	—
Net assets released from restrictions and used for operations	(4,207)	(5,105)
Restricted contributions and investment return	12,127	12,089
Net cash provided by (used in) financing activities	111,255	(6,049)
Change in cash and cash equivalents	18,403	(45,654)
Cash and cash equivalents at beginning of year	94,407	140,061
Cash and cash equivalents at end of year	\$ 112,810	94,407

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Consolidated Statements of Cash Flows

Years ended June 30, 2017 and 2016

(Dollars in thousands)

	2017	2016
Supplemental disclosure of cash flow information:		
Cash paid for interest, net of amounts capitalized	\$ 14,809	13,529
Supplemental disclosure of noncash transactions:		
Assets acquired under capital lease	\$ 1,045	4,447
Noncash transactions associated with acquisitions:		
Patients' account receivable	\$ 2,210	3,346
Inventories	175	423
Prepaid expenses	261	851
Investments	16,564	4,751
Property, plant and equipment	10,136	9,844
Other assets	507	130
Estimated third-party payor settlements	(297)	(5,374)
Accounts payable and accrued expenses	(2,628)	(3,460)
Other long-term liabilities	—	(1,939)
Long-term debt	(6,900)	(7,451)

See accompanying notes to consolidated financial statements.

HOSPITAL SISTERS HEALTH SYSTEM AND SUBSIDIARIES
Springfield, Illinois

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(Dollars in thousands)

(1) Organization and Purpose

Hospital Sisters Health System (HSHS), an Illinois not-for-profit corporation, considers all wholly owned or controlled entities as subsidiaries for consolidated financial statement purposes. The accompanying consolidated financial statements include the accounts of HSHS and its subsidiaries. HSHS is the parent corporation for several subsidiary corporations and exerts control through various reserved powers. The subsidiary corporations and controlled entities presented in the accompanying consolidated financial statements include Hospital Sisters Services, Inc. (HSSI), HSHS System Services Center (the SSC), Hospital Sisters of St. Francis Foundation, Inc. (the Foundation), and Kiara, Inc. HSSI, an Illinois not-for-profit holding company, is the sole member of 16 hospitals in Illinois and Wisconsin, Hospital Sisters Healthcare – West, Inc. (HCW), HSHS Medical Group, Inc., and HSHS Wisconsin Medical Group, Inc. (collectively, referred to as the Medical Group), Unity Limited Partnership, Kiara Clinical Integration Network (KCIN), Prairie Education & Research Cooperative (PERC), and Renaissance Quality Insurance, Ltd. (RQIL).

The hospitals are organized for the purpose of providing inpatient and outpatient healthcare services. HSSI formed the Medical Group for the purpose of affiliating with physicians. RQIL is a captive insurance company incorporated in the Cayman Islands to provide professional and general liability insurance coverage to HSHS and affiliates. Effective July 1, 2013, RQIL started providing workers compensation coverage for the hospitals.

16 hospitals within HSSI have formed an Obligated Group for debt financing purposes through the use of a Master Trust Indenture (MTI) (note 12).

The 16 hospitals, of which HSSI is the sole corporate member, are as follows:

Hospital	Location
	Illinois:
St. Elizabeth's Hospital (SEB)	Belleville
St. Joseph's Hospital (SJB)	Breese
St. Mary's Hospital (SMD)	Decatur
St. Anthony's Memorial Hospital (SAE)	Effingham
Holy Family Hospital (HFG)	Greenville
St. Joseph's Hospital (SJH)	Highland
St. Francis Hospital (SFL)	Litchfield
St. John's Hospital (SJS)	Springfield
Good Shepherd Hospital (GSS)	Shelbyville
St. Mary's Hospital (SMS)	Streator